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Press Release

Tough business conditions in Q3 2015 and anticipated positive impact exerted by implementing Solvency II on PZU's capital position

Softer market conditions on the capital markets, the price war and rising loss ratio in motor insurance have strongly affected PZU's results in Q3 2015. The Group's net financial result exceeds PLN 1.83 billion and is down 28.5% from last year's result. In these unfavorable conditions policy sales have nevertheless been record-breaking. PZU's gross written premium in the first nine months of 2015 has grown to a total of PLN 13.46 billion and is up 8.5% compared to the corresponding period of 2014. PZU's very robust capital position after the implementation of Solvency II as of 1 January 2016. The estimated calculation of the PZU Group's capital requirement and own funds according to the Solvency II rules based on data as at 31 December 2014 yields a coverage ratio of 303.4%. This places PZU among the top European insurers.

"In the first 9 months of 2015 the PZU Group may brag about excellent sales and retention of a satisfactory level of profitability. In particular, the newly-acquired companies made a contribution to the record-breaking gross written premium for which they deserve a lot of recognition. Unfortunately, the severe market conditions and sub-par conditions on the stock exchange impeded us from maintaining such robust results in the other segments. For instance, PZU's investment profit fell in comparison with the previous period by nearly one-third. Today, the overall insurance market must grapple with similar difficulties. The less satisfactory results do not however stand in the way of implementing the PZU 3.0 strategy calling for the Group to retain its leadership position in PZU's key business areas: insurance, health and investments. Our new newest undertaking is our exposure to the Polish banking sector launched by the purchase of a controlling stake in Alior Bank. We believe that in the upcoming years banking will become an equally robust foundation for PZU's operations as its other areas", said Andrzej Klesyk, CEO of PZU SA.

The following factors affected PZU Group's operations in the third quarter of 2015 in comparison to the corresponding period of the previous year:

- the increase in gross written premium thanks to the development of business in international markets, the premiums acquired by Link4 and the development of group protection insurance;
- lower profitability in the group and individually continued insurance segment associated mainly with the higher loss ratio of protection products;
- the decline in profitability in the mass insurance segment associated mainly with an increase in the loss ratio in motor insurance;
- the non-recurring result on the sale of PZU Lietuva;
- the lower result in the pension insurance segment related to the consequences of pension reform (OFE - open-end pension funds);
- lower investment income, in particular due to rising yields on Polish T-bonds and softer market conditions on capital markets.

In addition, the comparability of yoy results was affected by the expansion of business in Poland and the Baltic States in 2014. Last year, the acquired companies contributed to the PZU Group's result from the date of acquisition (the first acquired company, AAS Balta, starting from 30 June 2014), whereas in the results of the current year they are captured starting from 1 January, contributing to higher levels, relative to 2014, of individual items of financial performance and the assets and liabilities and equity.

Gross written premium

In the three quarters of 2015 gross written premium was PLN 13,461,279 thousand compared to PLN 12,408,778 thousand in the corresponding period of the previous year (+8.5%). The increase in sales applied above all to the following: international operations (chiefly the premium generated by the companies acquired in 2014); the regular premium in the group and individually continued insurance segment (mostly as a result of developing group protection insurance and generating premium in health insurance in group form); motor insurance in the mass client segment (mostly thanks to the premium generated by Link4) and motor own damage insurance in the corporate client segment (in connection with the significant growth in the number of insurance policies coupled with the falling average premium).

At the same time, falling gross written premium was recorded in third party liability insurance, insurance against fire and other damage to property in the corporate client segment, as well as in individual investment products in the bancassurance channel.

Investment activity

Investment income (including investment contracts, i.e. contracts that involve no significant insurance risk) in the first 3 quarters of 2015 and the first 3 quarters of 2014 was PLN 1,387,559 thousand and PLN 2,181,310 thousand, respectively, having decreased mainly due to the lower valuation of interest-bearing financial assets and deterioration in the market conditions on the capital markets.

Moreover, non-recurring profit on the sale of PZU Lietuva in the amount of PLN 166,971 thousand (impact on the net result of PLN 134,515 thousand) is recognized in the investment result in Q3 2015. This transaction was executed in connection with extending operations in the Baltic States by acquiring the leaders on the Lithuanian and Latvian markets for the purpose of satisfying the conditions for consent from the Lithuanian antitrust authority to acquire Lietuvos Draudimas.

Claims and benefits

The increase in net claims and benefits paid (taking into account movement in technical provisions) by PLN 667,743 thousand (+7.9%) as compared to the corresponding period of the previous year resulted in particular from the following: expansion in the group protection insurance portfolio (including health insurance with a higher loss ratio) and a higher loss ratio in a higher loss ratio in motor insurance as a result of the rising average claim and the growing number of reported claims.

Expenses

Acquisition expenses climbed PLN 166,498 thousand (+10.6%) in the first 3 quarters of 2015 compared to the corresponding period of the previous year. This growth was in particular the result of a higher level of indirect acquisition expenses in the mass client segment and consolidation of the insurance companies acquired in 2014.

The rise in administrative expenses by PLN 136,502 thousand (+12.9%) was driven mainly by the following factors: higher expenses related to implementing strategy 3.0 to develop the PZU Group's key areas (Retail and Corporate Client Area, PZU Health, distribution and operational support) and the inclusion of administrative expenses incurred by newly-acquired insurance companies in the PZU Group's results.

Profit

The net profit fell in comparison to the first three quarters of 2014 by PLN 731,439 thousand (-28.5%) to PLN 1,832,393 thousand.

Equity

IFRS-compliant consolidated equity as at 30 September 2015 was PLN 12,369,710 thousand compared to PLN 12,778,720 thousand as at 30 September 2014. Return on equity (ROE[1]) for the period from 1 January 2015 to 30 September 2015 was 19.1% making it 7.3 p.p. lower than in the corresponding period of the previous year. In comparison with consolidated equity as at 31 December 2014, equity fell by PLN 797,918 thousand (-6.1%).

Solvency

An important event for the insurance market is the completion of the work on the new Insurance and Reinsurance Activity Law, implementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of insurance and reinsurance ("Solvency II") into the Polish legal system. After parliamentary approval on 26 October 2015 and being signed by the President this Act will take force on 1 January 2016. According to the new act the calculation of the capital requirement is based on market, actuarial (insurance), counterparty insolvency, catastrophic and operational risks. Assets, liabilities and as a consequence own funds covering the capital requirement will be measured at fair value. The PZU Group conducted an estimated calculation of its capital requirement and own funds according to Solvency II based on data from 31 December 2014. The PZU Group's own funds according to Solvency II were PLN 19.7 billion and the capital requirement was PLN 6.5 billion, yielding coverage at the level of 303.4%.

[1] Annualized ratio.